

(Article for the Jakarta Globe – 15 October 2012 issue)

MONEY WISE

LIFE INSURANCE – CHOOSING THE RIGHT POLICY

Last week we reviewed the importance of life insurance. We also saw how the amount of cover needed is often seriously underestimated. For the main income earner with a young family a figure equivalent to ten times annual salary may still not be sufficient to maintain the family's way of life.

We also addressed the importance of not delaying a decision to take out insurance. Not only do premiums rise rapidly with age but should a serious illness or accident befall you the insurance companies may no longer wish to know you. So having agreed that action is called for where do you start?

What do you need and what can you afford?

Ideally, the exercise should start with a calculation of how much your family would need to replace your lost income, converted to a lump sum. This would include a projection of the cost of seeing your children through their planned education. You can obtain quotes from insurance companies to see what this would cost.

If the above exercise produces a figure beyond your means to cover then you will need to take a more realistic approach to determine how much you can actually afford to pay. There is no point in paying a premium that could become a serious burden or which you are unable to maintain, resulting in a policy lapsing.

Fortunately there are two main types of insurance, one of which is less costly.

Whole of Life

This is a form of insurance where after two or three initial years part of your premiums are invested in stocks, bonds and such like. The policy then starts to have an investment or surrender value. If you maintain the policy over a number of years, typically as much as 15 or 20, the surrender value could be in excess of the premiums you have paid. In fact, if your premiums are sufficiently high and the investment performs well you could build up a sum to the point

where it can continue to fund the policy and you do not need to pay further premiums.

There is however a factor that is working against you and that is your age. Even though the premiums remain the same the actual cost of insuring you rises every year so that a greater call is placed on the underlying investment. If the latter is not growing fast enough the cost of cover could swallow up the remaining funds to the point of exhaustion. At this point the policy would have to be terminated or you would have to agree a higher premium. Ideally this should not happen and the policy should sustain itself for the 'whole of life' as per its definition.

Level Term Assurance

This is a far more economic form of cover. Depending on the term selected, which would typically be from 10 to 20 years, the fixed premium is based on the average cost of cover over the term. The downside is that the policy has no investment or surrender value. It automatically lapses without value at the end of the term. The big plus factor is the lower cost.

Term assurance is also available for just one year. This would be cheaper still in the early years but would rise sharply with each year of age so it would not be a good idea for the longer term, although it might suit someone who needed cover for a limited period.

Death is not the only risk

While life insurance is well understood it is easy to overlook the risk of living but being unable to work. In certain circumstances it could be even worse if the breadwinner survives but needs expensive ongoing care.

Medical insurance is the first line of defense. It is vital to be covered yet this in itself does not cover loss of earnings. Ideally, critical illness insurance should be bolted on to life cover. This would pay out a sum of money in the event of the insured suffering one of a list of critical illnesses, including the most common ones of stroke, heart disease or cancer. Considering that more people actually suffer a critical illness and survive than actually die before the age of 65, there should be a greater awareness of critical illness. Of course cost is an issue and due to the high probability of a claim that is no surprise.

Striking a balance

At the end of the day, everyone has to determine how much they require to live a comfortable life and how much can be allocated to protect that way of life, not forgetting also the importance of saving for the future.

All of which makes financial planning an important and complex task for us all.

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